

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Refer Reply To:  
CC:PSI:B04 – PLR-106100-03  
Date: SEPTEMBER 28, 2004

Re:

Legend:

Date 1	=
Year 1	=
Year 2	=
Year 3	=
Year 4	=
Grantor	=
Trust	=
Stock	=
Partnership	=
Daughter	=
Son	=
Grandchild 1	=
Grandchild 2	=
Grandchild 3	=
Grandchild 4	=
\$X	=
State	=
State Statute	=

Dear \_\_\_\_\_ :

This is in response to a correspondence dated August 23, 2004, and prior correspondence, requesting a ruling regarding the generation-skipping transfer (GST) tax consequences of a proposed modification of Trust.

The facts submitted and representations made are as follows. On Date 1, a date prior to September 25, 1985, Grantor created and irrevocable trust (Trust) for the primary benefit of the children of Grantor's daughter (Daughter), Grandchild 1, Grandchild 2,

Grandchild 3, and Grandchild 4. Trust named Daughter and another person as trustees of Trust. Trust was funded with Stock. It is represented that the situs of Trust is State and that State law governs the administration of Trust.

Article 2, paragraph 2.01 of Trust provides, generally, that the trustee will pay over to any one or more of Grandchild 1, Grandchild 2, Grandchild 3, Grandchild 4, and their descendants, so much of the net income of the trust as the trustees in their discretion deem to be in the best interests of the beneficiaries. In addition the trustees may pay over to any one or more of Grandchild 1, Grandchild 2, Grandchild 3, Grandchild 4, and their descendants so much or all of the principal of the trust as the trustees in their discretion deem desirable for the "welfare" of any of the beneficiaries or for the education of any of the descendants of Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4. The Trust instrument provides that the term "welfare" includes "payments for the beneficiaries' health, support or advancement in life and generally for the well-being of the beneficiary. . ." The Trust instrument also provides that it is the Grantor's desire and intention that Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4 be the primary beneficiaries of the trust and their needs are to be given first consideration before the needs of their descendants. In exercising their discretion to allocate the income and distribute the principal of the trust, the trustees may, but need not, treat the grandchildren equally and may, but need not, take into account their other income and resources.

Article 2, paragraph 2.02 provides that unless the trust is sooner terminated by principal distributions to the beneficiaries, the trust will terminate on the death of the last to die of Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4. Upon termination, the remaining trust property is to be distributed to Daughter's descendants, per stirpes. If there are no living descendants of Daughter, then property is to be distributed to the descendants of Grantor's son, Son.

Beginning in Year 1, in a series of transactions, the trustees sold Stock for a combination of cash, promissory notes, and a partnership interest in Partnership. The cash proceeds received from the sale and the cash payments received on the promissory notes were distributed by the trustees equally to Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4.

The interest in Partnership was sold for cash in Year 2. A portion of the sales proceeds was placed in escrow pending resolution of various issues. During Year 3, one-quarter of the balance of the sales proceeds that was not placed in escrow was distributed to each of Grandchild 1, Grandchild 2, and Grandchild 4. Each received approximately \$X. No distribution was made to Grandchild 3. During Year 4, the pending issues were resolved and the amount held in the escrow account was distributed to Trust. The trustees paid one-quarter of the escrow distribution to each of Grandchild 1, Grandchild 2, and Grandchild 4. No distribution was made to Grandchild 3.

It is represented that the trustees and Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4 agreed orally that Trust would be administered as four separate shares, one share for each grandchild and his respective descendants. The Trust distributions described above were made in view of this understanding. The parties also represent and agree that the property currently held in Trust represents solely the share attributable to Grandchild 3 and his descendants, that the property is held solely for the benefit of Grandchild 3 and his descendants, and that Grandchild 1, Grandchild 2, Grandchild 4, and their respective descendants have no interest in the remaining corpus of Trust.

It is further represented that the trustees will seek a court order modifying Trust to reflect the understanding of the trustees and beneficiaries, as described above. Specifically, the trustees will petition the court to modify Trust by means of a judicial reformation as follows.

The first paragraph of Article 1 of Trust will be modified to state that Trust is established “for the benefit of Grandchild 3, and also for the benefit of his descendants, all as more fully set forth below.” Article 2, paragraph 2.01 will be modified to designate Grandchild 3 and his descendants as the sole income and principal beneficiaries of Trust. Paragraph 2.02 will be modified to provide that on the termination of Trust, the remaining corpus will be distributed to the descendants of Grandchild 3, per stirpes, and if there are no descendants then living, to the descendants of Daughter, per stirpes. Article 4 will be modified to provide that if any trustee ceases to act for any reason the remaining trustee may act alone. If neither trustee appointed under the instrument qualifies or acts as trustee then Grandchild 3, if living, may appoint a successor trustee. If Grandchild 3 is not living, then a successor trustee may be appointed by a majority of the beneficiaries. In all other respects, the dispositive provisions of Trust will remain the same (except that Grandchild 3 and his descendants are the sole beneficiaries), and the Trust will terminate at the same time as provided under the Trust terms prior to modification.

In addition, two new provisions will be added to Article 8 of Trust. The first provision provides, generally, that no trustee will exercise discretionary powers over income or principal or terminate any trust to discharge the trustee’s legal obligation to support any beneficiary. The second provision provides, generally, that if any person is both a trustee and a beneficiary, such person will not exercise the discretionary power to distribute income or principal to himself in excess of what is necessary for such person’s support, maintenance, health and education.

You have requested a ruling that the proposed modification to Trust by judicial reformation will not terminate the generation-skipping transfer tax exempt-status of

Trust and will not cause Trust to be subject to the generation-skipping transfer tax provisions of chapter 13 of the Internal Revenue Code (Code).

Section 2601 of the Code imposes a tax on each generation skipping transfer. Under section 1433(b)(2)(A) of the Tax Reform Act of 1986 Act and § 26.2601-1(b)(1)(I) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that the transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

Section 26.2601-1(b)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in § 26.2601-1(b)(1)(ii)(B) or (C) (relating to property includible in the grantor's gross estate under §§ 2038 and 2042).

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy paragraph (b)(4)(i)(A), (B), or (C) of this section) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, but only if –

(1) The modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and

(2) The modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Section 26.2601-1(b)(4)(i)(E), Example 5, describes a situation where, in 1980, Grantor established an irrevocable trust for the benefit of his two children, A and B, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of A and B, the trust principal is to be

distributed to the living issue of A and B, per stirpes. In 2002, the appropriate local court approved the division of the trust into two equal trusts, one for the benefit of A and A's issue and one for the benefit of B and B's issue. The trust for A and A's issue provides that the trustee has the discretion to distribute trust income and principal to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust principal is to be distributed equally to A's issue, per stirpes. If A dies with no living descendants, the principal will be added to the trust for B and B's issue. The trust for B and B's issue is identical (except for the beneficiaries), and terminates at B's death at which time the trust principal is to be distributed equally to B's issue, per stirpes. If B dies with no living descendants, principal will be added to the trust for A and A's issue. The example concludes that the division of the trust into two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the division. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13 of the Code.

In this case, Trust was irrevocable prior to September 25, 1985. Also, it is represented that no additions have been made to Trust after September 25, 1985. Consequently, Trust is currently exempt from GST tax.

In the instant case, it is represented that pursuant to an agreement of the parties, Trust has been administered as four separate shares, one share for each grandchild and his descendants, and trust corpus has been distributed in accordance with this understanding. The proposed modifications are consistent with the manner in which the trust has been administered. Further, the proposed addition to Article 8 is consistent with applicable State law that would apply in the absence of the modification. See State Statute. Based on the facts presented and representations made, we conclude that the proposed modifications to Article 1, Article 2, Article 4 and Article 8 of Trust, discussed above, will not shift any beneficial interest in Trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the division. In addition, these proposed modifications of Trust will not extend the time for vesting of any beneficial interest in the trusts beyond the period provided for in the original trust. See, e.g., §26.2601-1(b)(4)(i)(E), Example 5. Accordingly, based on the facts submitted and the representations made, if the appropriate local court issues an order approving the modification to Trust, the proposed modification will not terminate the generation-skipping transfer tax exempt-status of Trust and will not cause Trust to be subject to the generation-skipping transfer tax provisions of chapter 13.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under

any other provisions of the Code. Specifically, we express no opinion regarding whether the distributions to Grandchild 1, Grandchild 2, and Grandchild 4, were authorized under the terms of the Trust instrument or State law.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

George Masnik  
Chief, Branch 4  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure

Copy for section 6110 purposes

cc: